No. 83-1023

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

DATA PROBE ACQUISITION CORP. and DATA PROBE, INC.,

Petitioners,

—against—

DATATAB, INC., SANFORD C. ADAMS, LEE D. GALLAHER, JOHN L. LOBEL, CRC INFORMATION SYSTEMS, INC., and CRC ACQUISITION CORP.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether there is a direct conflict on an important issue of federal law between the holding of the Second Circuit in this case and the holding of the Sixth Circuit in *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981). The Second Circuit held that, absent deception, an option to purchase a controlling block of stock granted by the target company to its merger partner is not a manipulative act under Section 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(e). The Sixth Circuit held in the *Mobil* case that, even without deception, an option to purchase a substantial block of stock and assets of the target company granted by the target company to a competing tender offeror in connection with a tender offer is a manipulative act in violation of Section 14(e).

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Statement of the Case

Respondents[1] take exception to Petitioners' Statement of the Case. It is argumentative and fails to fairly set forth the material facts in a neutral fashion. A fair statement of the material facts is set forth in the opinion of the United States

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1 Respondent corporations CRC Information Systems, Inc. and CRC Acquisition Corp., a wholly owned subsidiary of CRC Information Systems, Inc., have no parent companies, subsidiaries (except wholly-owned subsidiaries) or affiliated companies.

Court of Appeals for the Second Circuit (A-3 through A-6), which for the convenience of this Court is summarized below.

Respondent Datatab, Inc. ("Datatab") had a history of substantial losses in recent years, which led to a deterioration of its financial condition. Therefore, in mid-December 1982, Datatab approached Respondent CRC Information Systems, Inc. ("CRC") to inquire as to whether CRC would be interested in acquiring Datatab. Negotiations with a view to such an acquisition then commenced (A-3).

On March 4, 1983, Datatab issued a public release to the effect that CRC had proposed to acquire Datatab by merger at a price of $1.00 per share. During the first quarter of 1983, the bid quotations for Datatab stock ranged between $9/16 and $7/8.

On April 29, 1983, Datatab, CRC, and Respondent CRC Acquisition Corp. ("CRC Acquisition") entered into an Agreement and Plan of Merger (the "Merger Agreement"), pursuant to which, subject to the approval of the Merger Agreement by the holders of two-thirds of the outstanding shares of Common Stock of Datatab, CRC Acquisition would be merged into Datatab, shareholders of Datatab would receive $1.00 for each share of Common Stock held by them, and Datatab would become a wholly-owned subsidiary of CRC (A-3).

The requisite proxy material for a Special Meeting of Shareholders of Datatab to act on the Merger Agreement was then filed with and cleared by the Securities and Exchange Commission ("SEC"). Among many other things, the proxy material disclosed that the three directors of Datatab had been offered three year contracts by CRC which in the aggregate were $700 more per year than the directors were then earning (A-14).

On June 21, 1983, two days before the scheduled shareholders' meeting, Petitioners Data Probe, Inc. ("Data Probe") and Data Probe Acquisition ("DPAC") made a tender offer for any or all shares of the Common Stock of Datatab at a price of $1.25 per share, conditioned, *inter alia*, upon the

merger with CRC being rejected by the shareholders of Datatab or abandoned. The scheduled shareholders' meeting was subsequently adjourned to August 8, 1983. Because of the instant lawsuit by Data Probe and DPAC, commenced in the United States District Court for the Southern District of New York, and events related thereto, the meeting became academic and was never held (A-4).

On July 1, 1983, Datatab, CRC and CRC Acquisition entered into an agreement (the "July 1 Agreement"), under which the Merger Agreement was amended to provide that: (a) shareholders of Datatab would receive $1.40 for each share of Datatab Common Stock owned by them; (b) CRC would loan up to $210,000 to Datatab for working capital at interest rates below market; and (c) CRC was granted an option (the "Option") to purchase 1,407,674 shares of authorized but unissued voting stock of Datatab at a price of $1.40 per share. If the Option were exercised in full, CRC would own approximately two-thirds of the then outstanding voting power of Datatab (A-5).

Datatab mailed an announcement of the execution of the July 1 Agreement in letter form to its shareholders on July 1, 1983 and delivered to Data Probe and DPAC a copy of the letter and the July 1 Agreement (A-5).

On July 14, 1983, Data Probe and DPAC amended their tender offer to increase the price thereunder to $1.55 per share, conditioned, *inter alia*, upon the Option being held invalid. On the same day, Petitioners commenced an action in the United States District Court for the Southern District of New York against Datatab, its directors, CRC and CRC Acquisition, alleging *inter alia*, that the granting of the Option was a "manipulative act or practice" in violation of Section 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(e) (the "Williams Act"). The Complaint alleged no violations of state law (A-6).

On July 28, 1983 Judge Sofaer issued an order declaring the Option invalid under Section 14(e) because it "unduly ob-

structed the exercise of informed shareholder choice" (A-6). Petitioners announced on the same day they would begin accepting shares that had been, or would be, tendered in response to their tender offer. Petitioners have acquired approximately 60% of the issued and outstanding shares of Common Stock of Datatab (A-6).

On November 22, 1983, the Second Circuit unanimously reversed Judge Sofaer and held that the "gravamen of the wrong alleged is a breach of fiduciary duty" which is not a cognizable claim under Section 14(e) (A-7 and A-8).[2]

Summary of Argument

1. There is no direct conflict between the decision of the Sixth Circuit in *Mobil v. Marathon Oil Corp.*, 669 F.2d 366 (6th Cir. 1981) and the present case because the decision in *Mobil* related to the grant of an option to purchase stock *and* assets *in connection with a tender offer*, while the decision of the Second Circuit related to the granting of an option to purchase stock *in connection with a merger agreement*.

2. The issue to be decided in this case is not of great public importance because:

(a) it is confined to a limited factual situation, *i.e.*, where an option to purchase stock of the target company is granted to a merger partner after the announcement of a tender offer;

(b) the dispute is limited to the two companies seeking control of the target and does not affect the public, since all public shareholders of the target have either received the highest price offered for their stock or have been given the opportunity to receive such price; and

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2 The Second Circuit did not reach the issue as to whether Petitioners had standing as tender offerors to sue for injunctive relief, an issue this Court left open in *Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977) (A-7).

(c) it may well become moot by reason of recommended legislation.

3. The decision below is clearly correct and is controlled by decisions of this Court, including *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977) and *Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977).

Accordingly, certiorari should be denied or, if granted, an order should be entered affirming the decision of the Second Circuit on the merits.

ARGUMENT

I.

Preliminary Statement

Much of the Petition is devoted to arguing the merits of Petitioners' case and maligning the motives of Respondents with respect to the granting of the Option. Respondents will not engage in similar tactics. They do, however, wish to point out that:

1. Representatives of Datatab and CRC had executed the Merger Agreement prior to the announcement of the tender offer by Petitioners (A-3);

2. The record shows that representatives of Datatab and CRC bargained in good faith with respect to increasing the merger price and the granting of the Option;

3. Contrary to the suggestion in Petitioners' brief, the exercise price per share of the shares covered by the Option exceeded by $.15 the price that had been offered to the public shareholders by Petitioners at the time the Option was granted (A-4, A-5); and that exercise price was also equal to the amended merger price (A-4). Further, the record shows that, without the Option, CRC would not have increased the merger price over the amount first offered by Petitioners; and

4. The record shows that directors of Datatab did not have any personal interest in granting the Option to CRC.

In any event, all such issues relate to the fiduciary duties of the Datatab directors under state law.[3]

II.

The Decision Below Does Not Directly Conflict With the Sixth Circuit's Decision in *Mobil v. Marathon*

The precise question before the Court in *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981) was whether the "Yates Field and stock options granted by Marathon to USS, the wholly-owned subsidiary of U.S. Steel, constitute a manipulative act or practice *in connection with the USS tender offer* of November 19, 1981 in violation of Section 14(e)." 669 F.2d 373 (emphasis added). In the present case, CRC and Datatab had entered into the Merger Agreement on April 29, 1983, some two months *before* Data Probe announced its tender offer (A-3 and A-4). Subsequent to the announcement, CRC and Datatab "concluded a revised merger agreement" which, in part, contained the challenged Option (A-5).

Thus, in *Mobil* the challenged options on the stock and assets of the target company were clearly granted to defendant U.S. Steel "in connection with a tender offer", *i.e.*, the tender offer of defendant U.S. Steel. Consequently, there was no issue with respect to that element of Section 14(e). In this case, Respondents argued below that the Option was granted in connection with the Merger Agreement and not in connection with a tender offer, and hence did not come within Section 14(e).[4] This argument was rejected by the District Court (A-43)

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3 On December 1, 1983, Petitioners commenced an action in the Supreme Court of the State of New York, County of New York, seeking, among other things, a judgment declaring the Option invalid, on the ground that in granting the Option the directors of Datatab breached their fiduciary duties.

4 See Nathan, "Novel Legal Questions Explored," *National Law Journal*, March 29, 1982.

and was not passed upon by the Second Circuit although raised in Respondents' brief at p.27. Since this Court may decide this case without reaching the issue relating to the alleged conflict, *i.e.*, the interpretation of the word "manipulative" in Section 14(e), it should decline review under traditional standards. Cf. *The Monrosa v. Carbon Black, Inc.*, 359 U.S. 180 (1959).

Mobil is also distinguishable because it involved the granting of options by the target to purchase shares of stock *and* valuable assets, while the instant case involves only the granting of an option to purchase stock.

Lastly, in *Mobil*, U.S. Steel was given the option to purchase the target company's stock at a price of $30 per share less than the public shareholders had been offered, while in this case the exercise price per share of the shares covered by the Option was the same as that offered to the public shareholders under the Merger Agreement as amended by the July 1 Agreement.

III.

The Decision Below Does Not Raise Questions of Great Public Importance

Review should not be granted where the "impact of the conflict is narrowly confined and is not apt to have continuing future consequences." Harlan, *Manning the Dikes* (1958), 13 Record NYCBA 541,552. Resolution of the issues presented for review in the present case does not involve a constitutional question or one of national importance.

If the Merger Agreement, which was executed two months before the announcement of the tender offer, had contained the Option originally, clearly the Option would not have been subject to Section 14(e) because it would not have been granted "in connection with a tender offer." Neither the Second Circuit's opinion nor the *Mobil* decision would be applicable. Thus, if this Court grants review, its decision will be limited to the narrow situation where the sequence of events is a merger agreement between two companies, followed by a tender offer

by a third party and a subsequent amendment to the merger agreement which includes an option on the shares of the target. To avoid any consequence of a ruling by this Court, the merger partners could simply include an option as part of the initial merger agreement.

Moreover, the issues before this Court pertain solely to the immediate parties, Data Probe and CRC. When the District Court declared the Option invalid, Data Probe voluntarily chose to proceed with its tender offer, so that all public shareholders received or were offered the right to receive, $1.55 per share for their stock (A-6). Accordingly, shareholder protection, which this Court in *Piper v. Chris-Craft Industries Inc.*, 430 U.S.1 (1977) held to be the purpose of the Williams Act, is not of concern in this case.

On July 8, 1983, the SEC Advisory Committee on Tender Offers issued a "Report of Recommendations," Fed. Sec. Law Special Rep. No. 1028 (CCH), July 15, 1983. The Report recommends to the SEC that "by rule making or by recommending legislation, or regulation, as may be required" options, such as the one granted in this case, should be presented for shareholder approval (p.2 of July 8 transmittal letter and p. 44 of the Report). Hence, the issue which the Petitioners seek to have reviewed may well become moot.

The issue involved is further limited by the fact that it is confined to "over-the-counter" stocks. This is so because stock exchange rules require shareholder approval of the issuance of more than approximately 20% of a listed company's outstanding shares. *See, e.g.*, New York Stock Exchange Listed Company Manual, § 312; American Stock Exchange Company Guide, ¶ 713.

The decision of the Second Circuit does not mean the demise of tender offers, as argued by Petitioners (p.9), but simply that, absent deception, shareholders will be relegated to their traditional remedies under state law for breaches of fiduciary duties by directors. Indeed, this is what Petitioners have done in commencing the state action previously described (see footnote 1, *supra*).

Contrary to Petitioners' argument, the interpretation of a federal statute does not in and of itself create an important issue of federal law which requires review. If that were so, this Court would obviously be under even greater burdens, considering the magnitude of federal legislation. Moreover, as pointed out in Point IV, *infra*, prior decisions of this Court interpreting Section 14(e) and comparable language in other statutes have settled any question as to the issues involved herein.

IV.

The Decision Below Is Correct and in Full Accord With Controlling Decisions of This Court

Edgar v. Mite Corp., 457 U.S. 624 (1982), cited by Petitioners, is inapplicable to the case at bar. *Edgar v. Mite Corp.* held that the Illinois Takeover Statute under review was unconstitutional because it imposed an impermissible burden on interstate commerce, a rationale inapplicable to the dispute between Petitioners and Respondents which involves private acts. The *Mite* plurality addressed the extent to which states may regulate tender offers through timing and other requirements and held that states may not through legislation impose regulations that give an advantage to either the tender offeror or the target.

Rather than looking to *Edgar v. Mite Corp.*, Respondents submit that the determination of the issues involved on the merits is governed by the decisions of this Court in *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977); *Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977); *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49 (1975); and *Buffalo Forge Co. v. Ogden Corp.*, 555 F. Supp. 892 (W.D.N.Y. 1983), *aff'd* ____ F.2d ____ (2d Cir. Sept. 22, 1983), *cert. denied* 52 U.S.L.W. 3461 (Dec. 12, 1983).

The teaching of this Court as to the purpose of the Securities Exchange Act of 1934 ("Exchange Act"), of which the Wil-

liams Act is a part, is unequivocal: its "fundamental purpose" is to implement a "philosophy of full disclosure," and not to regulate the "fairness of the terms of the transaction." *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 477-78; *see also, Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976). Like the Exchange Act as a whole, the Williams Act amendments were "designed solely to get needed information to the investor." *Piper*, 430 U.S. at 31; *accord, Rondeau v. Mosinee Paper Corp.*, 422 U.S. at 58.

The Exchange Act's prohibition of "manipulative" acts or practices refers to "practices such as wash sales, matched orders, or rigged prices, that are intended to *mislead* investors by artificially affecting market activity." *Santa Fe*, 430 U.S. at 476 (emphasis added). Petitioners have not contended that anyone was misled by the acts of which they complain and the Second Circuit held that there were no misleading or manipulative acts in the instant case.

Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), had been law for thirty-four years when the Williams Act was enacted and the judicial interpretations of it were numerous. The only distinction between Sections 10(b) and 14(e) drawn by the courts is that a violation of the former requires a purchase or sale of securities, while the the latter requires that the violation occur in connection with a tender offer. See, *e.g.*, *Gulf & Western Industries, Inc. v. Great A&P Tea Co. Inc.*, 476 F.2d 687, 696 (2d Cir. 1973) and *Hurwitz v. R.B. Jones Corp.*, 76 F.R.D. 149 (W.D. Mo. 1977). There is nothing in its legislative history or elsewere to suggest that the wording of Section 14(e), which is virtually the same as Section 10(b), should be given a different meaning. This conclusion is consistent with the fact that both sections are part of the same statute the purpose of which is to insure full disclosure to the public and not to regulate corporate management. This Court should not "[a]bsent a clear indication of congressional intent . . . federalize the substantial portion of the law of corporations that deals with transactions in securities, especially where established state policies of corporate regulation would be overridden." *Santa Fe*, 430 U.S at 479.

The Option is not equivalent to a wash sale or matched order, as suggested by Petitioners (pp. 12-13), and thus is not within the classic definition of manipulation. A wash sale is where the same person is the buyer and the seller; in a matched order one person sells knowing another person has put in an order to buy at the same price and for the same quantity. 3 L. LOSS, SECURITIES REGULATION 1530 (2nd Ed. 1961). Section 9(a)(1)(A) of the Exchange Act, 15 U.S.C. § 78i, is directed to wash sales; Section 9(a)(1) (B) and (C) is directed to matched orders. In either case it must be shown that the purpose of the activity was to create "a false or misleading sense of active trading . . . or a false or misleading appearance with respect to the market" for the security. Section 9(a)(1). It is clear that wash sales and matched orders are condemned because they are misleading. They create an image of arm's length market activity where in actuality there is none. The Option is not such a device because it does not create a false picture of market activity.

This case is virtually the same as *Buffalo Forge*, in which the Court recently denied a petition for certiorari, and we submit that the Court should do likewise herein.

However, if the Court were to grant Petitioners' request for review, Respondents submit that an order should be entered pursuant to Rule 23.1 affirming the decision of the Second Circuit on the merits. Respondents believe that such an order would be appropriate because of the controlling cases referred to above and the fact that Petitioners, who control 60% of Datatab, have sought to use the filing of their Petition as a basis for a stay of the state action brought by them, arguing that a reversal of the Second Circuit's decision would render the state action moot. Respondents further direct the Court's attention to the facts that the Option, by its terms, expires on June 30, 1984, that Petitioner Data Probe is a business competitor of CRC and that each day Data Probe remains in control of Datatab the value of the Option to CRC diminishes.

At the very least, this Court should discontinue the stay of the Second Circuit's mandate.

Conclusion

For the reasons stated above, the Court is respectfully requested to deny the application for a writ of certiorari to review the decision of the United States Court of Appeals for the Second Circuit, or, in the alternative, to grant such application and issue an order affirming the decision of the Second Circuit on the merits, or, in the further alternative, to discontinue the stay of the Second Circuit's mandate.

Dated: January 17, 1984

Respectfully submitted,

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